Publication 527 (2022), Residential Rental Property | Internal Revenue Service

Jan. 1st, 2022 Send to Kindle

For use in preparing Returns

For the latest information about developments related to Pub. 527, such as legislation enacted after it was published, go to IRS.gov/Pub527.

Standard mileage rate. For 2022, the standard mileage rate for the cost of operating your car, van, pickup, or panel truck between January 1, 2022, to June 30, 2022, is 58.5 cents per mile. The business standard mileage rate from July 1, 2022, to December 31, 2022, is 62.5 cents per mile.

Excess business loss limitation. If you report a loss on line 26, 32, 37, or 39 of your Schedule E (Form 1040), you may be subject to a business loss limitation. The disallowed loss resulting from the limitation will not be reflected on line 26, 32, 37, or 39 of your Schedule E. Instead, use Form 461 to determine the amount of your excess business loss, which will be included as income on Schedule 1 (Form 1040), line 8p. Any disallowed loss resulting from this limitation will be treated as a net operating loss that must be carried forward and deducted in a subsequent year.See Form 461 and its instructions for details on the excess business loss limitation.

Section 179 deduction dollar limits. For tax years beginning in 2022, the maximum section 179 expense deduction is $1,080,000. This limit is reduced by the amount by which the cost of section 179 property placed in service during the tax year exceeds $2,700,000.

Form 7205, Energy Efficient Commercial Buildings Deduction. This new form and its separate instructions are used to claim the IRC 179D deduction for qualifying energy efficient commercial building expense(s).

Qualified paid sick leave and qualified paid family leave payroll tax credit. The amount of any payroll tax credit taken by an employer for qualified paid sick leave and qualified paid family leave under the Families First Coronavirus Response Act (FFCRA) and the American Rescue Plan Act (ARP) must be included in income. See Form 941, lines 11b, 11d, 13c, and 13e; and Form 944, lines 8b, 8d, 10d, and 10f. You must include the full amount (both the refundable and nonrefundable portions) of the credit for qualified sick and family leave wages in gross income on line 3 or 4, as applicable, for the tax year that includes the last day of any calendar quarter with respect to which a credit is allowed.

Note.

A credit is available only if the leave was taken after March 31, 2020, and before October 1, 2021, and only after the qualified leave wages were paid, which might, under certain circumstances, not occur until a quarter after September 30, 2021, including quarters during 2022. Accordingly, all lines related to qualified sick and family leave wages remain on the employment tax returns for 2022.

Net Investment Income Tax (NIIT). You may be subject to the NIIT. NIIT is a 3.8% tax on the lesser of net investment income or the excess of modified adjusted gross income (MAGI) over the threshold amount. Net investment income may include rental income and other income from passive activities. Use Form 8960 to figure this tax. For more information on NIIT, go to IRS.gov/NIIT.

Self-employed tax payments deferred from 2020. If you elected to defer self-employed tax payments from 2020, see How self-employed individuals and household employers repay deferred Social Security tax for more information about due dates and payment options.

Photographs of missing children. The Internal Revenue Service is a proud partner with the National Center for Missing & Exploited Children® (NCMEC). Photographs of missing children selected by the Center may appear in this publication on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling 1-800-THE-LOST (1-800-843-5678) if you recognize a child.

Do you own a second house that you rent out all the time? Do you own a vacation home that you rent out when you or your family isn't using it?

These are two common types of residential rental activities discussed in this publication. In most cases, all rental income must be reported on your tax return, but there are differences in the expenses you are allowed to deduct and in the way the rental activity is reported on your return.

Chapter 1 discusses rental-for-profit activity in which there is no personal use of the property. It examines some common types of rental income and when each is reported, as well as some common types of expenses and which are deductible.

Chapter 2 discusses depreciation as it applies to your rental real estate activity—what property can be depreciated and how much it can be depreciated.

Chapter 3 covers the reporting of your rental income and deductions, including casualties and thefts, limitations on losses, and claiming the correct amount of depreciation.

Chapter 4 discusses special rental situations. These include condominiums, cooperatives, property changed to rental use, renting only part of your property, and a not-for-profit rental activity.

Chapter 5 discusses the rules for rental income and expenses when there is also personal use of the dwelling unit, such as a vacation home.

Finally, chapter 6 explains how to get tax help from the IRS.

Comments and suggestions.

We welcome your comments about this publication and suggestions for future editions.

You can send us comments through IRS.gov/FormComments. Or, you can write to the Internal Revenue Service, Tax Forms and Publications, 1111 Constitution Ave. NW, IR-6526, Washington, DC 20224.

Although we can't respond individually to each comment received, we do appreciate your feedback and will consider your comments and suggestions as we revise our tax forms, instructions, and publications. **Don't** send tax questions, tax returns, or payments to the above address.
You may want to see:

Publication

- 463 Travel, Gift, and Car Expenses
- 523 Selling Your Home
- 534 Depreciating Property Placed in Service Before 1987
- 535 Business Expenses

- 544 Sales and Other Dispositions of Assets
- 547 Casualties, Disasters, and Thefts
- 551 Basis of Assets
- 925 Passive Activity and At-Risk Rules
- 946 How To Depreciate Property

Form (and Instructions)

- 461 Excess Business Loss Limitation
- 4562 Depreciation and Amortization
- 5213 Election To Postpone Determination as To Whether the Presumption Applies That an Activity Is Engaged in for Profit
- 7205 Energy Efficient Commercial Buildings Deduction
- 8582 Passive Activity Loss Limitations
- 8960 Net Investment Income Tax—Individuals, Estates, and Trusts
- Schedule E (Form 1040) Supplemental Income and Loss

This chapter discusses the various types of rental income and expenses for a residential rental activity with no personal use of the dwelling. Generally, each year, you will report all income and deduct all out-ofpocket expenses in full. The deduction to recover the cost of your rental property—depreciation—is taken over a prescribed number of years, and is discussed in chapter 2.

This is an Image: caution.gif *.If your rental income is from property you also use personally or rent to someone at less than a fair rental price, first read chapter 5..*

In most cases, you must include in your gross income all amounts you receive as rent. Rental income is any payment you receive for the use or occupation of property. It isn't limited to amounts you receive as normal rental payments.

When you report rental income on your tax return generally depends on whether you are a cash or an accrual basis taxpayer. Most individual taxpayers use the cash method.

In most cases, the expenses of renting your property, such as maintenance, insurance, taxes, and interest, can be deducted from your rental income.

You generally deduct your rental expenses in the year you pay them.

If you use the accrual method, see Pub. 538 for more information.

Listed below are the most common rental expenses.

- Advertising.

- Auto and travel expenses.
- Cleaning and maintenance.
- Commissions.
- Depreciation.
- Insurance.
- Interest (other).
- Legal and other professional fees.
- Local transportation expenses.
- Management fees.
- Mortgage interest paid to banks, etc.
- Points.
- Rental payments.
- Repairs.
- Taxes.
- Utilities.

Some of these expenses, as well as other less common ones, are discussed below.

Local transportation expenses.

You may be able to deduct your ordinary and necessary local transportation expenses if you incur them to collect rental income or to manage, conserve, or maintain your rental property. However, transportation expenses incurred to travel between your home and a rental property generally constitute nondeductible commuting costs unless you use your home as your principal place of business. See Pub. 587, Business Use of Your Home, for information on determining if your home office qualifies as a principal place of business.

Generally, if you use your personal car, pickup truck, or light van for rental activities, you can deduct the expenses using one of two methods: actual expenses or the standard mileage rate. For 2022, the standard mileage rate for business use is 58.5 cents per mile from January 1, 2022, to June 30, 2022. From July 1, 2022, to December 31, 2022, the standard mileage rate for business use is 62.5 cents per mile. For more information, see chapter 4 of Pub. 463.

This is an Image: files.gif . *To deduct car expenses under either method, you must keep records that follow the rules in chapter 5 of Pub. 463. In addition, you must complete Form 4562, Part V, and attach it to your tax return.* .

The term “points” is often used to describe some of the charges paid, or treated as paid, by a borrower to take out a loan or a mortgage. These charges are also called loan origination fees, maximum loan charges, or premium charges. Any of these charges (points) that are solely for the use of money are interest. Because points are prepaid interest, you generally can't deduct the full amount in the year paid, but must deduct the interest over the term of the loan.

The method used to figure the amount of points you can deduct each year follows the original issue discount (OID) rules. In this case, points are equivalent to OID, which is the difference between:

- Stated redemption price at maturity (generally the stated principal amount or amount borrowed) over
- Issue price (generally the proceeds).

If the difference is equal to or less than zero, the amount of OID is zero.

The first step is to determine whether your total OID (which you may have on bonds or other investments in addition to the mortgage loan), including the OID resulting from the points, is insignificant or de minimis. If the OID isn't de minimis, you must use the constant-yield method to figure how much you can deduct.

Example—Year 1.

The facts are the same as in the previous example. The YTM on Carol's loan is 10.2467%, compounded annually.

She figured the amount of points (OID) she could deduct in 2022 as follows.

To figure your deduction in any subsequent year, you start with the adjusted issue price. To get the adjusted issue price, add to the issue price figured in Year 1 any OID previously deducted. Then, follow steps (2) and (3), earlier.

Example—Year 2.

Carol figured the deduction for 2023 as follows.

You recover the cost of income-producing property through yearly tax deductions. You do this by depreciating the property; that is, by deducting some of the cost each year on your tax return.

Three factors determine how much depreciation you can deduct each year: (1) your basis in the property, (2) the recovery period for the property, and (3) the depreciation method used. You can't simply deduct your mortgage or principal payments, or the cost of furniture, fixtures, and equipment, as an expense.

You can deduct depreciation only on the part of your property used for rental purposes. Depreciation reduces your basis for figuring gain or loss on a later sale or exchange.

You may have to use Form 4562 to figure and report your depreciation. See *Which Forms To Use* in chapter 3. Also, see Pub. 946.

The following section discusses the information you will need to have about the rental property and the decisions to be made before figuring your depreciation deduction.

You can depreciate your property if it meets all the following requirements.

- You own the property.
- You use the property in your business or income-producing activity (such as rental property).
- The property has a determinable useful life.
- The property is expected to last more than 1 year.

Certain property can't be depreciated. This includes land and certain excepted property.

Land.

You can't depreciate the cost of land because land generally doesn't wear out, become obsolete, or get used up. But if it does, the loss is accounted for upon disposition. The costs of clearing, grading, planting, and landscaping are usually all part of the cost of land and can't be depreciated. You may, however, be able to depreciate certain land preparation costs if the costs are so closely associated with other depreciable property that you can determine a life for them along with the life of the associated property.

Example.

You built a new house to use as a rental and paid for grading, clearing, seeding, and planting bushes and trees. Some of the bushes and trees were planted right next to the house, while others were planted around the outer border of the lot. If you replace the house, you would have to destroy the bushes and trees right next to it. These bushes and trees are closely associated with the house, so they have a determinable useful life. Therefore, you can depreciate them. Add your other land preparation costs to the basis of your land because they have no determinable life and you can't depreciate them.

You begin to depreciate your rental property when you place it in service for the production of income. You stop depreciating it either when you have fully recovered your cost or other basis, or when you retire it from service, whichever happens first.

You place property in service in a rental activity when it is ready and available for a specific use in that activity. Even if you aren't using the property, it is in service when it is ready and available for its specific use.

Example 1.

On November 22 of last year, you purchased a dishwasher for your rental property. The appliance was delivered on December 7, but wasn't installed and ready for use until January 3 of this year. Because the dishwasher wasn't ready for use last year, it isn't considered placed in service until this year.

If the appliance had been installed and ready for use when it was delivered in December of last year, it would have been considered placed in service in December, even if it wasn't actually used until this year.

Example 2.

On April 6, you purchased a house to use as residential rental property. You made extensive repairs to the house and had it ready for rent on July 5. You began to advertise the house for rent in July and actually rented it beginning September 1. The house is considered placed in service in July when it was ready and available for rent. You can begin to depreciate the house in July.

Example 3.

You moved from your home in July. During August and September, you made several repairs to the house. On October 1, you listed the property for rent with a real estate company, which rented it on December 1. The property is considered placed in service on October 1, the date when it was available for rent.

Continue to claim a deduction for depreciation on property used in your rental activity even if it is temporarily idle (not in use). For example, if you must make repairs after a tenant moves out, you still depreciate the rental property during the time it isn't available for rent.

You must stop depreciating property when the total of your yearly depreciation deductions equals your cost or other basis of your property. For this purpose, your yearly depreciation deductions include any depreciation that you were allowed to claim, even if you didn't claim it. See *Basis of Depreciable Property*, later.

You stop depreciating property when you retire it from service, even if you haven't fully recovered its cost or other basis. You retire property from service when you permanently withdraw it from use in a trade or business or from use in the production of income because of any of the following events.

- You sell or exchange the property.
- You convert the property to personal use.
- You abandon the property.
- The property is destroyed.

Generally, you must use the Modified Accelerated Cost Recovery System (MACRS) to depreciate residential rental property placed in service after 1986.

If you placed rental property in service before 1987, you are using one of the following methods.

- Accelerated Cost Recovery System (ACRS) for property placed in service after 1980 but before 1987.

- Straight line or declining balance method over the useful life of property placed in service before 1981.

See *MACRS Depreciation*, later, for more information.

This is an Image: caution.gif *.This publication discusses MACRS depreciation only. If you need information about depreciating property placed in service before 1987, see Pub. 534..*

The basis of property used in a rental activity is generally its adjusted basis when you place it in service in that activity. This is its cost or other basis when you acquired it, adjusted for certain items occurring before you place it in service in the rental activity.

If you depreciate your property under MACRS, you may also have to reduce your basis by certain deductions and credits with respect to the property.

Basis and adjusted basis are explained in the following discussions.

This is an Image: caution.gif *.If you used the property for personal purposes before changing it to rental use, its basis for depreciation is the lesser of its adjusted basis or its FMV when you change it to rental use. See* Basis of Property Changed to Rental Use *in chapter 4..*

You can’t use cost as a basis for property that you received:

- In return for services you performed;

- In an exchange for other property;
- As a gift;
- From your spouse, or from your former spouse as the result of a divorce; or
- As an inheritance.

If you received property in one of these ways, see Pub. 551 for information on how to figure your basis.

To figure your property's basis for depreciation, you may have to make certain adjustments (increases and decreases) to the basis of the property for events occurring between the time you acquired the property and the time you placed it in service for business or the production of income. The result of these adjustments to the basis is the adjusted basis.

For 2022, some properties used in connection with residential real property activities may qualify for a special depreciation allowance. This allowance is figured before you figure your regular depreciation deduction. See chapter 3 of Pub. 946 for details. Also, see the instructions for Form 4562, line 14.

If you qualify for, but choose not to take, a special depreciation allowance, you must attach a statement to your return. The details of this election are in chapter 3 of Pub. 946 and the instructions for Form 4562, line 14.

Most business and investment property placed in service after 1986 is depreciated using MACRS.

This section explains how to determine which MACRS depreciation system applies to your property. It also discusses other information you need to know before you can figure depreciation under MACRS. This information includes the property's:

- Recovery class,
- Applicable recovery period,
- Convention,
- Placed-in-service date,
- Basis for depreciation, and
- Depreciation method.

MACRS consists of two systems that determine how you depreciate your property—the General Depreciation System (GDS) and the Alternative Depreciation System (ADS). You must use GDS unless you are specifically required by law to use ADS or you elect to use ADS.

You can't use MACRS for certain personal property (such as furniture or appliances) placed in service in your rental property in 2022 if it had been previously placed in service before 1987, when MACRS became effective.

In most cases, personal property is excluded from MACRS if you (or a person related to you) owned or used it in 1986 or if your tenant is a person (or someone related to the person) who owned or used it in 1986. However, the property isn't excluded if your 2022 deduction under MACRS (using a half-year convention) is less than the deduction you would have under ACRS. For more information, see *What Method Can You Use To Depreciate Your Property?* in chapter 1 of Pub. 946.

If you choose, you can use the ADS method for most property. Under ADS, you use the straight line method of depreciation.

The election of ADS for one item in a class of property generally applies to all property in that class placed in service during the tax year of the election. However, the election applies on a property-by-property basis for residential rental property and nonresidential real property.

If you choose to use ADS for your residential rental property, the election must be made in the first year the property is placed in service. Once you make this election, you can never revoke it.

For property placed in service during 2022, you make the election to use ADS by entering the depreciation on Form 4562, Part III, Section C, line 20c.

Each item of property that can be depreciated under MACRS is assigned to a property class, determined by its class life. The property class generally determines the depreciation method, recovery period, and convention.

The property classes under GDS are:

- 3-year property,
- 5-year property,
- 7-year property,
- 10-year property,
- 15-year property,
- 20-year property,
- Nonresidential real property, and
- Residential rental property.

Under MACRS, property that you placed in service during 2022 in your rental activities generally falls into one of the following classes.

- **5-year property.** This class includes computers and peripheral equipment, office machinery (typewriters, calculators, copiers, etc.), automobiles, and light trucks.

  This class also includes appliances, carpeting, and furniture used in a residential rental real estate activity.

  Depreciation is limited on automobiles and other property used for transportation and property of a type generally used for entertainment, recreation, or amusement. See chapter 5 of Pub. 946.

- **7-year property.** This class includes office furniture and equipment (desks, file cabinets, and similar items). This class also includes any property that doesn't have a class life and that hasn't been designated by law as being in any other class.

- **15-year property.** This class includes roads, fences, and shrubbery (if depreciable).

- **Residential rental property.** This class includes any real property that is a rental building or structure (including a mobile home) for which 80% or more of the gross rental income for the tax year is from dwelling units. It doesn't include a unit in a hotel, motel, inn, or other establishment where more than half of the units are used on a transient basis. If you live in any part of the building or structure, the gross rental income includes the fair rental value of the part you live in.

This is an Image: caution.gif *.The other property classes generally don't apply to property used in rental activities. These classes aren't discussed in this publication. See Pub. 946 for more information..*

The recovery period of property is the number of years over which you recover its cost or other basis. The recovery periods are generally longer under ADS than GDS.

The recovery period of property depends on its property class. Under GDS, the recovery period of an asset is generally the same as its property class.

Class lives and recovery periods for most assets are listed in *Appendix B* of Pub. 946. See Table 2-1 for recovery periods of property commonly used in residential rental activities.

A convention is a method established under MACRS to set the beginning and end of the recovery period. The convention you use determines the number of months for which you can claim depreciation in the year you place property in service and in the year you dispose of the property.

Example.

During the tax year, Tom purchased the following items to use in his rental property. He elects not to claim the special depreciation allowance discussed earlier.

- A dishwasher for $400 that he placed in service in January.
- Used furniture for $100 that he placed in service in September.
- A refrigerator for $800 that he placed in service in October.

Tom uses the calendar year as his tax year. The total basis of all property placed in service that year is $1,300. The $800 basis of the refrigerator placed in service during the last 3 months of his tax year exceeds $520 (40% × $1,300). Tom must use the mid-quarter convention instead of the half-year convention for all three items.

You can figure your MACRS depreciation deduction in one of two ways. The deduction is substantially the same both ways. You can figure the deduction using either:

- The depreciation method and convention that apply over the recovery period of the property, or
- The percentage from the MACRS percentage tables.

In this publication, we will use the percentage tables. For instructions on how to compute the deduction, see chapter 4 of Pub. 946.

5-, 7-, or 15-year property.

For property in the 5- or 7-year class, use the 200% declining balance (DB) method and a half-year convention. However, in limited cases, you must use the mid-quarter convention, if it applies. For property in the 15-year class, use the 150% DB method and a half-year convention, unless the mid-quarter convention applies.

You can also choose to use the 150% DB method for property in the 5- or 7-year class. The choice to use the 150% method for one item in a class of property applies to all property in that class that is placed in service during the tax year of the election. You make this election on Form 4562. In Part III, column (f), enter “150 DB.” Once you make this election, you can’t change to another method.

If you use either the 200% or 150% DB method, figure your deduction using the straight line method in the first tax year that the use of the straight line method gives you an equal or larger deduction than the use of the 200% or 150% DB method.

You can also choose to use the straight line method with a half-year or mid-quarter convention for 5-, 7-, or 15-year property. The choice to use the straight line method for one item in a class of property applies to all property in that class that is placed in service during the tax year of the election. You elect the straight line method on Form 4562. In Part III, column (f), enter “S/L.” Once you make this election, you can’t change to another method.

You can use the percentages in Table 2-2 to compute annual depreciation under MACRS. The tables show the percentages for the first few years or until the change to the straight line method is made. See *Appendix A* of Pub. 946 for complete tables. The percentages in Tables 2-2a, 2-2b, and 2-2c make the change from using the DB method to the straight line method in the first tax year that the use of the straight line method gives you an equal or greater deduction than the use of the DB method.

If you elect to use the straight line method for 5-, 7-, or 15-year property, or the 150% DB method for 5- or 7-year property, use the tables in *Appendix A* of Pub. 946.

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Tables 2-2a, 2-2b, and 2-2c.

The percentages in these tables take into account the half-year and mid-quarter conventions. Use Table 2-2a for 5-year property, Table 2-2b for 7-year property, and Table 2-2c for 15-year property. Use the percentage in the second column (half-year convention) unless you are required to use the mid-quarter convention (explained earlier). If you must use the mid-quarter convention, use the column that corresponds to the calendar year quarter in which you placed the property in service.

Example 1.

You purchased a stove and refrigerator and placed them in service in June. Your basis in the stove is $600 and your basis in the refrigerator is $1,000. Both are 5-year property. Using the half-year convention column in Table 2-2a, the depreciation percentage for Year 1 is 20%. For that year, your depreciation deduction is $120 ($600 × 20% (0.20)) for the stove and $200 ($1,000 × 20% (0.20)) for the refrigerator.

For Year 2, the depreciation percentage is 32%. That year's depreciation deduction will be $192 ($600 × 32% (0.32)) for the stove and $320 ($1,000 × 32% (0.32)) for the refrigerator.

Example 2.

Assume the same facts as in *Example 1*, except you buy the refrigerator in October instead of June. Because the refrigerator was placed in service in the last 3 months of the tax year, and its basis ($1,000) is more than 40% of the total basis of all property placed in service during the year ($1,600 × 40% (0.40) = $640), you are required to use the mid-quarter convention to figure depreciation on both the stove and refrigerator.

Because you placed the refrigerator in service in October, you use the fourth quarter column of Table 2-2a and find the depreciation percentage for Year 1 is 5%. Your depreciation deduction for the refrigerator is $50 ($1,000 x 5% (0.05)).

Because you placed the stove in service in June, you use the second quarter column of Table 2-2a and find the depreciation percentage for Year 1 is 25%. For that year, your depreciation deduction for the stove is $150 ($600 x 25% (0.25)).

Table 2-1 shows the ADS recovery periods for property used in rental activities.

See *Appendix B* of Pub. 946 for other property. If your property isn't listed in *Appendix B*, it is considered to have no class life. Under ADS, personal property with no class life is depreciated using a recovery period of 12 years.

Use the mid-month convention for residential rental property and nonresidential real property. For all other property, use the half-year or mid-quarter convention, as appropriate.

See Pub. 946 for ADS depreciation tables.

You should claim the correct amount of depreciation each tax year. If you didn't claim all the depreciation you were entitled to deduct, you must still reduce your basis in the property by the full amount of depreciation that you could have deducted. For more information, see *Depreciation* under *Decreases to Basis* in Pub. 551.

If you deducted an incorrect amount of depreciation for property in any year, you may be able to make a correction by filing Form 1040-X, Amended U.S. Individual Income Tax Return. If you aren't allowed to make the correction on an amended return, you may be able to change your accounting method to claim the correct amount of depreciation. See *How Do You Correct Depreciation Deductions?* in Pub. 946 for more information.

Figuring the net income or loss for a residential rental activity may involve more than just listing the income and deductions on Schedule E (Form 1040). There are activities that don't qualify to use Schedule E, such as when the activity isn't engaged in to make a profit or when you provide substantial services in conjunction with the property.

There are also the limitations that may need to be applied if you have a net loss on Schedule E. There are two: (1) the limitation based on the amount of investment you have at risk in your rental activity, and (2) the special limits imposed on passive activities.

You may also have a gain or loss related to your rental property from a casualty or theft. This is considered separately from the income and expense information you report on Schedule E.

The basic form for reporting residential rental income and expenses is Schedule E (Form 1040). However, don't use that schedule to report a not-for-profit activity. See *Not Rented for Profit*, later, in chapter 4. There are also other rental situations in which forms other than Schedule E would be used.

If you rent buildings, rooms, or apartments, and provide basic services such as heat and light, trash collection, etc., you normally report your rental income and expenses on Schedule E, Part I.

List your total income, expenses, and depreciation for each rental property. Be sure to enter the number of fair rental and personal-use days on line 2.

If you have more than three rental or royalty properties, complete and attach as many Schedules E as are needed to separately list all of the properties. However, fill in lines 23a through 26 on only one Schedule E. The figures on lines 23a through 26 on that Schedule E should be the combined totals for all properties reported on your Schedules E.

On Schedule E, page 1, line 18, enter the depreciation you are claiming for each property. You may also need to attach Form 4562 to claim some or all of your depreciation. See *Form 4562*, later, for more information.

If you have a loss from your rental real estate activity, you may also need to complete one or both of the following forms.

Page 2 of Schedule E is used to report income or loss from partnerships, S corporations, estates, trusts, and real estate mortgage investment conduits. If you need to use page 2 of Schedule E and you have more than three rental or royalty properties, be sure to use page 2 of the same Schedule E you used to enter the combined totals for your rental activity on page 1. Also, include the amount from line 26 (Part I) in the "Total income or (loss)" on line 41 (Part V).

Generally, Schedule C is used when you provide substantial services in conjunction with the property or the rental is part of a trade or business as a real estate dealer.

Providing substantial services.

If you provide substantial services that are primarily for your tenant's convenience, such as regular cleaning, changing linen, or maid service, you report your rental income and expenses on Schedule C. Use Form 1065, U.S. Return of Partnership Income, if your rental activity is a partnership (including a partnership with your spouse unless it is a qualified joint venture). Substantial services don't include the furnishing of heat and light, cleaning of public areas, trash collection, etc. For more information, see Pub. 334, Tax Guide for Small Business. Also, you may have to pay self-employment tax on your rental income using Schedule SE (Form 1040), Self-Employment Tax. For a discussion of "substantial services," see *Real Estate Rents* in chapter 5 of Pub. 334.

If you and your spouse each materially participate (see *Material participation* under *Passive Activity Limits*, later) as the only members of a jointly owned and operated real estate business, and you file a joint return for the tax year, you can make a joint election to be treated as a qualified joint venture instead of a partnership. This election, in most cases, won't increase the total tax owed on the joint return, but it does give each of you credit for social security earnings on which retirement benefits are based and for Medicare coverage if your rental income is subject to self-employment tax.

If you make this election, you must report rental real estate income on Schedule E (or Schedule C, if you provide substantial services). You won't be required to file Form 1065 for any year the election is in effect. Rental real estate income generally isn't included in net earnings from self-employment subject to self-employment tax and is generally subject to the passive activity limits.

If you and your spouse filed a Form 1065 for the year prior to the election, the partnership terminates at the end of the tax year immediately preceding the year the election takes effect.

For more information on qualified joint ventures, go to IRS.gov/QJV.

If you have a loss from your rental real estate activity, two sets of rules may limit the amount of loss you can report on Schedule E. You must consider these rules in the order shown below. Both are discussed in this section.

1. At-risk rules. These rules are applied first if there is investment in your rental real estate activity for which you aren't at risk. This

applies only if the real property was placed in service after 1986.

2. Passive activity limits. Generally, rental real estate activities are considered passive activities and losses aren't deductible unless you have income from other passive activities to offset them. However, there are exceptions.

You may be subject to the at-risk rules if you have:

- A loss from an activity carried on as a trade or business or for the production of income, and
- Amounts invested in the activity for which you aren't fully at risk.

Losses from holding real property (other than mineral property) placed in service before 1987 aren't subject to the at-risk rules.

In most cases, any loss from an activity subject to the at-risk rules is allowed only to the extent of the total amount you have at risk in the activity at the end of the tax year. You are considered at risk in an activity to the extent of cash and the adjusted basis of other property you contributed to the activity and certain amounts borrowed for use in the activity. Any loss that is disallowed because of the at-risk limits is treated as a deduction from the same activity in the next tax year. See Pub. 925 for a discussion of the at-risk rules.

In most cases, all rental real estate activities (except those of certain real estate professionals, discussed later) are passive activities. For this purpose, a rental activity is an activity from which you receive income mainly for the use of tangible property, rather than for services. For a discussion of activities that aren't considered rental activities, see *Rental Activities* in Pub. 925.

Deductions or losses from passive activities are limited. You generally can't offset income, other than passive income, with losses from passive activities. Nor can you offset taxes on income, other than passive income, with credits resulting from passive activities. Any excess loss or credit is carried forward to the next tax year. Exceptions to the rules for figuring passive activity limits for personal use of a dwelling unit and for rental real estate with active participation are discussed later.

For a detailed discussion of these rules, see Pub. 925.

If you used the rental property as a home during the year, any income, deductions, gain, or loss allocable to such use is not to be taken into account for purposes of the passive activity loss limitation. Instead, follow the rules explained in chapter 5.

If you or your spouse actively participated in a passive rental real estate activity, you may be able to deduct up to $25,000 of loss from the activity from your nonpassive income. This special allowance is an exception to the general rule disallowing losses in excess of income from passive activities. Similarly, you may be able to offset credits from the activity against the tax on up to $25,000 of nonpassive income after taking into account any losses allowed under this exception.

Example.

Jane is single and has $40,000 in wages, $2,000 of passive income from a limited partnership, and $3,500 of passive loss from a rental real estate activity in which she actively participated. $2,000 of Jane's $3,500 loss offsets her passive income. The remaining $1,500 loss can be deducted from her $40,000 wages.

This is an Image: caution.gif *.The special allowance isn't available if you were married, lived with your spouse at any time during the year, and are filing a separate return. .*

Maximum special allowance.

The maximum special allowance is:

- $25,000 for single individuals and married individuals filing a joint return for the tax year,
- $12,500 for married individuals who file separate returns for the tax year and lived apart from their spouses at all times during the tax year, and
- $25,000 for a qualifying estate reduced by the special allowance for which the surviving spouse qualified.

If your MAGI is $100,000 or less ($50,000 or less if married filing separately), you can deduct your loss up to the amount specified above. If your MAGI is more than $100,000 (more than $50,000 if married filing separately), your special allowance is limited to 50% of the difference between $150,000 ($75,000 if married filing separately) and your MAGI.

Generally, if your MAGI is $150,000 or more ($75,000 or more if you are married filing separately), there is no special allowance.

In February 2017, Marie bought a rental house for $135,000 (house $120,000 and land $15,000) and immediately began renting it out. In 2022, she rented it all 12 months for a monthly rental fee of $1,125. In addition to her rental income of $13,500 (12 x $1,125), Marie had the following expenses.

Marie depreciates the residential rental property under MACRS GDS. This means using the straight line method over a recovery period of 27.5 years.

She uses Table 2-2d to find her depreciation percentage. Because she placed the property in service in February 2017, she continues to use that row of Table 2-2d. For year 6, the rate is 3.636%.

Marie figures her net rental income or loss for the house as follows.

Marie had a net loss for the year. Because she actively participated in her passive rental real estate activity and her loss was less than $25,000, she can deduct the loss on her return. Marie also meets all of the requirements for not having to file Form 8582. She uses Schedule E, Part I, to report her rental income and expenses. She enters her income, expenses, and depreciation for the house in the column for Property A and enters her loss on line 22. Form 4562 isn't required.

This chapter discusses some rental real estate activities that are subject to additional rules.

A condominium is most often a dwelling unit in a multi-unit building, but can also take other forms, such as a townhouse or garden apartment.

If you own a condominium, you also own a share of the common elements, such as land, lobbies, elevators, and service areas. You and the other condominium owners may pay dues or assessments to a special corporation that is organized to take care of the common elements.

Special rules apply if you rent your condominium to others. You can deduct as rental expenses all the expenses discussed in chapters 1 and 2. In addition, you can deduct any dues or assessments paid for maintenance of the common elements.

You can't deduct special assessments you pay to a condominium management corporation for improvements. However, you may be able to recover your share of the cost of any improvement by taking depreciation.

If you live in a cooperative, you don't own your apartment. Instead, a corporation owns the apartments and you are a tenant-stockholder in the cooperative housing corporation. If you rent your apartment to others, you can usually deduct, as a rental expense, all the maintenance fees you pay to the cooperative housing corporation.

In addition to the maintenance fees paid to the cooperative housing corporation, you can deduct your direct payments for repairs, upkeep, and other rental expenses, including interest paid on a loan used to buy your stock in the corporation.

You will be depreciating your stock in the corporation rather than the apartment itself. Figure your depreciation deduction as follows.

1. Figure the depreciation for all the depreciable real property owned by the corporation. (Depreciation methods are discussed in chapter 2 of this publication and Pub. 946.) If you bought your cooperative stock after its first offering, figure the depreciable basis of this property as follows.

    a. Multiply your cost per share by the total number of outstanding shares.

    b. Add to the amount figured in (a) any mortgage debt on the property on the date you bought the stock.

    c. Subtract from the amount figured in (b) any mortgage debt that isn't for the depreciable real property, such as the part for the land.

2. Subtract from the amount figured in (1) any depreciation for space owned by the corporation that can be rented but can't be lived in by tenant-stockholders.

3. Divide the number of your shares of stock by the total number of shares outstanding, including any shares held by the corporation.

4. Multiply the result of (2) by the percentage you figured in (3). This is your depreciation on the stock.

Your depreciation deduction for the year can't be more than the part of your adjusted basis (defined in chapter 2) in the stock of the corporation that is allocable to your rental property.

Payments added to capital account.

Payments earmarked for a capital asset or improvement, or otherwise charged to the corporation's capital account, are added to the basis of your stock in the corporation. For example, you can't deduct a payment used to pave a community parking lot, install a new roof, or pay the principal of the corporation's mortgage.

Treat as a capital cost the amount you were assessed for capital items. This can't be more than the amount by which your payments to the corporation exceeded your share of the corporation's mortgage interest and real estate taxes.

Your share of interest and taxes is the amount the corporation elected to allocate to you, if it reasonably reflects those expenses for your apartment. Otherwise, figure your share in the following manner.

1. Divide the number of your shares of stock by the total number of shares outstanding, including any shares held by the corporation.
2. Multiply the corporation's deductible interest by the number you figured in (1). This is your share of the interest.
3. Multiply the corporation's deductible taxes by the number you figured in (1). This is your share of the taxes.

If you change your home or other property (or a part of it) to rental use at any time other than the beginning of your tax year, you must divide yearly expenses, such as taxes and insurance, between rental use and personal use.

You can deduct as rental expenses only the part of the expense that is for the part of the year the property was used or held for rental purposes.

You can't deduct depreciation or insurance for the part of the year the property was held for personal use. However, you can include the home mortgage interest and real estate tax expenses for the part of the year the property was held for personal use when figuring the amount you can deduct on Schedule A.

Example.

Your tax year is the calendar year. You moved from your home in May and started renting it out on June 1. You can deduct as rental expenses seven-twelfths of your yearly expenses, such as taxes and insurance.

Starting with June, you can deduct as rental expenses the amounts you pay for items generally billed monthly, such as utilities.

When figuring depreciation, treat the property as placed in service on June 1.

When you change property you held for personal use to rental use (for example, you rent your former home), the basis for depreciation will be the lesser of the FMV or adjusted basis on the date of conversion.

If you change your cooperative apartment to rental use, figure your allowable depreciation as explained earlier. (Depreciation methods are discussed in chapter 2 of this publication and Pub. 946.) The basis of all the depreciable real property owned by the cooperative housing corporation is the smaller of the following amounts.

- The FMV of the property on the date you change your apartment to rental use. This is considered to be the same as the corporation's adjusted basis minus straight line depreciation, unless this value is unrealistic.
- The corporation's adjusted basis in the property on that date. Don't subtract depreciation when figuring the corporation's adjusted basis.

If you bought the stock after its first offering, the corporation's adjusted basis in the property is the amount figured in (1) under *Depreciation*, earlier. The FMV of the property is considered to be the same as the corporation's adjusted basis figured in this way minus straight line depreciation, unless the value is unrealistic.

To figure the deduction, use the depreciation system in effect when you convert your residence to rental use. Generally, that will be MACRS for any conversion after 1986. Treat the property as placed in service on the conversion date.

Example.

Your converted residence (see the previous example under *Figuring the basis*, earlier) was available for rent on August 1. Using Table 2-2d (see chapter 2), the percentage for Year 1 beginning in August is 1.364% and the depreciation deduction for Year 1 is $2,005 ($147,000 × 0.01364).

If you rent part of your property, you must divide certain expenses between the part of the property used for rental purposes and the part of the property used for personal purposes, as though you actually had two separate pieces of property.

You can deduct the expenses related to the part of the property used for rental purposes, such as home mortgage interest and real estate taxes, as rental expenses on Schedule E (Form 1040). You can also deduct as rental expenses a portion of other expenses that are normally nondeductible personal expenses, such as expenses for electricity or painting the outside of the house.

There is no change in the types of expenses deductible for the personal-use part of your property. Generally, these expenses may be deducted only if you itemize your deductions on Schedule A (Form 1040).

You can’t deduct any part of the cost of the first phone line even if your tenants have unlimited use of it.

You don’t have to divide the expenses that belong only to the rental part of your property. For example, if you paint a room that you rent or pay premiums for liability insurance in connection with renting a room in your home, your entire cost is a rental expense. If you install a second phone line strictly for your tenant′s use, all the cost of the second line is deductible as a rental expense. You can deduct depreciation on the part of the house used for rental purposes as well as on the furniture and equipment you use for rental purposes.

If you don’t rent your property to make a profit, you can’t deduct rental expenses in excess of the amount of your rental income. You can’t deduct a loss or carry forward to the next year any rental expenses that are more than your rental income for the year.

In January, Eileen bought a condominium apartment to live in. Instead of selling the house she had been living in, she decided to change it to rental property. Eileen selected a tenant and started renting the house on February 1. Eileen charges $750 a month for rent and collects it herself. Eileen also received a $750 security deposit from her tenant. Because she plans to return it to her tenant at the end of the lease, she doesn't include it in her income. Her rental expenses for the year are as follows.

Eileen must divide the real estate taxes, mortgage interest, and fire insurance between the personal use of the property and the rental use of the property. She can deduct eleven-twelfths of these expenses as rental expenses. She can include the balance of the real estate taxes and mortgage interest when figuring the amount she can deduct on Schedule A if she itemizes. She can't deduct the balance of the fire insurance because it is a personal expense.

Eileen bought this house in 1987 for $35,000. Her property tax was based on assessed values of $10,000 for the land and $25,000 for the house. Before changing it to rental property, Eileen added several improvements to the house. She figures her adjusted basis as follows.

On February 1, when Eileen changed her house to rental property, the property had an FMV of $152,000. Of this amount, $35,000 was for the land and $117,000 was for the house.

Because Eileen's adjusted basis is less than the FMV on the date of the change, Eileen uses $39,000 as her basis for depreciation.

As specified for residential rental property, Eileen must use the straight line method of depreciation over the GDS or ADS recovery period. She chooses the GDS recovery period of 27.5 years.

She uses Table 2-2d to find her depreciation percentage. Because she placed the property in service in February, the percentage is 3.182%.

On April 1, Eileen bought a new dishwasher for the rental property at a cost of $425. The dishwasher is personal property used in a rental real estate activity, which has a 5-year recovery period. She uses Table 2-2a to find the depreciation percentage for Year 1 under “Half-year convention” (20%) to figure her depreciation deduction.

On May 1, Eileen paid $4,000 to have a furnace installed in the house. The furnace is residential rental property. Because she placed the property in service in May, the depreciation percentage from Table 2-2d is 2.273%.

Eileen figures her net rental income or loss for the house as follows.

Eileen uses Schedule E, Part I, to report her rental income and expenses. She enters her income, expenses, and depreciation for the house in the column for Property A. Because all property was placed in service this year, Eileen must use Form 4562 to figure the depreciation. See the Instructions for Form 4562 for more information on preparing the form.

If you have any personal use of a dwelling unit (including a vacation home) that you rent, you must divide your expenses between rental use and personal use. In general, your rental expenses will be no more than your total expenses multiplied by a fraction, the denominator of which is the total number of days the dwelling unit is used and the numerator of which is the total number of days actually rented at a fair rental price. Only your rental expenses may be deducted on Schedule E (Form 1040). Some of your personal expenses may be deductible on Schedule A (Form 1040) if you itemize your deductions.

You must also determine if the dwelling unit is considered a home. The amount of rental expenses that you can deduct may be limited if the dwelling unit is considered a home. Whether a dwelling unit is considered a home depends on how many days during the year are considered to be days of personal use. There is a special rule if you used the dwelling unit as a home and you rented it for less than 15 days during the year.

Dwelling unit.

A dwelling unit includes a house, apartment, condominium, mobile home, boat, vacation home, or similar property. It also includes all structures or other property belonging to the dwelling unit. A dwelling unit has basic living accommodations, such as sleeping space, a toilet, and cooking facilities.

A dwelling unit doesn’t include property (or part of the property) used solely as a hotel, motel, inn, or similar establishment. Property is used solely as a hotel, motel, inn, or similar establishment if it is regularly available for occupancy by paying customers and isn’t used by an owner as a home during the year.

Example.

You rent a room in your home that is always available for short-term occupancy by paying customers. You don't use the room yourself and you allow only paying customers to use the room. This room is used solely as a hotel, motel, inn, or similar establishment and isn't a dwelling unit.

If you use a dwelling unit for both rental and personal purposes, divide your expenses between the rental use and the personal use based on the number of days used for each purpose.

When dividing your expenses, follow these rules.

- Any day that the unit is rented at a fair rental price is a day of rental use even if you used the unit for personal purposes that day. (This rule doesn't apply when determining whether you used the unit as a home.)
- Any day that the unit is available for rent but not actually rented isn't a day of rental use.

Example.

Your beach cottage was available for rent from June 1 through August 31 (92 days). Except for the first week in August (7 days), when you were unable to find a renter, you rented the cottage at a fair rental price during that time. The person who rented the cottage for July allowed you to use it over the weekend (2 days) without any reduction in or refund of rent. Your family also used the cottage during the last 2 weeks of May (14 days). The cottage wasn't used at all before May 17 or after August 31.

You figure the part of the cottage expenses to treat as rental expenses as follows.

- The cottage was used for rental a total of 85 days (92 – 7). The days it was available for rent but not rented (7 days) aren't days of rental use. The July weekend (2 days) you used it is rental use because you received a fair rental price for the weekend.

- You used the cottage for personal purposes for 14 days (the last 2 weeks in May).

- The total use of the cottage was 99 days (14 days personal use + 85 days rental use).

- Your rental expenses are 85/99 (86%) of the cottage expenses.

When determining whether you used the cottage as a home, the July weekend (2 days) you used it is considered personal use even though you received a fair rental price for the weekend. Therefore, you had 16 days of personal use and 83 days of rental use for this purpose. Because you used the cottage for personal purposes more than 14 days and more than 10% of the days of rental use (8 days), you used it as a home. If you have a net loss, you may not be able to deduct all of the rental expenses. See *Dwelling Unit Used as a Home* next.

Used as a home and rented 15 days or more.

If you use a dwelling unit as a home and rent it 15 days or more during the year, include all your rental income in your income. Because you used the dwelling unit for personal purposes, you must divide your expenses between the rental use and the personal use as described earlier in this chapter under *Dividing Expenses*. The expenses for personal use aren't deductible as rental expenses.

If you had a net profit from renting the dwelling unit for the year (that is, if your rental income is more than the total of your rental expenses, including depreciation), deduct all of your rental expenses. You don't need to use Worksheet 5-1.

However, if you had a net loss from renting the dwelling unit for the year, your deduction for certain rental expenses is limited. To figure your deductible rental expenses and any carryover to next year, use Worksheet 5-1.
